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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 374

TICONIC NATIONAL BANK, PEOPLES-TICONIC NATIONAL BANK, AND ARTHUR G. PICHER, AS RECEIVER OF BOTH SAID BANKS, PETITIONERS

v.

LOTTIE F. SPRAGUE AND MARGARET DAVIS SPRAGUE, RESPONDENTS

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF ON BEHALF OF THE RECONSTRUCTION FINANCE CORPORATION AS AMICUS CURIAE

STATEMENT

A national bank accepting funds in trust for investment and using the same, pending investment, in the conduct of its business is required by Section 11 (k) of the Federal Reserve Act and Section 9 (b) of Regulation F of the Regulations of the Board of Governors of the Federal Reserve System to deliver to and maintain in its trust department,

as collateral security, United States bonds or other securities having at all times a market value at least equal to the amount of such funds. Upon the failure of such a bank, prior to investment of such funds, the owner thereof has a lien on the bonds or other securities so set apart in addition to his claim against the estate of the bank. The question presented here is whether that lien extends to interest. The District Court and the Circuit Court of Appeals both held that the lien extended to interest to the date of payment, calculated, however, only from the date on which suit was started.

The approach to the question involved in the petition for the writ of certiorari herein to the Circuit Court of Appeals for the First Circuit indicates that petitioners have construed certain decisions of this Court as indicating that the lien of a secured creditor of a national bank is limited, in case of suspension of such a bank, to principal unless the assets of the bank prove to be sufficient to pay all the debts and engagements of the bank in full, plus interest. It is because of that approach and because of the fact that Reconstruction Finance Corporation is a secured creditor of various insolvent banks that this brief is filed.

This brief is directed to the question of the extent of the lien of a secured creditor of a national bank rather than solely to the narrower question, as to the claim for interest on uninvested trust funds, presented by the record in this case.

SUMMARY OF ARGUMENT

It is submitted, *first*, that the liens of secured contract creditors of a national bank extend to interest to the date of payment; and, *second*, that it would be detrimental to national banks if a rule existed to the effect that the appointment of a receiver for such a bank limited the liens of such creditors.

I

THE LIEN OF A SECURED CONTRACT CREDITOR OF A NATIONAL BANK EXTENDS TO INTEREST TO THE DATE OF PAYMENT

Security posted for the performance of a contract to repay money with stated interest equally secures both the promise to repay the principal sum and the promise to pay interest as stated.

A secured creditor's lien is not limited to principal or to principal and a part of interest by the appointment of a trustee in bankruptcy for his debtor. Bankruptcy Act, Section 67d; *Coder* v. *Arts*, 213 U. S. 223. Nor is a secured creditor's lien so limited by the appointment of a receiver in equity for the affairs of the debtor. *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261; *Board of County Commissioners of Sweetwater County* v. *Bernardin* (C. C. A. 10th), 74 Fed. (2d) 809, certiorari denied, 295 U. S. 731; *First National Bank* v. *J. I. Campbell Co.*, 114 S. W. 887 (Tex. Civ. App. 1908). Nor does any such limitation take place in case the assets of the debtor, being a state bank, are taken over for liqui-

dation by the State Banking Department. *State, ex rel. Hansen* v. *Chelan County,* 185 Wash. 327, 54 Pac. (2d) 1006 (1936).

For the reasons briefly discussed below, we submit that a secured creditor's rights in and to his collateral are in no wise limited or affected by the appointment of a receiver for his debtor merely because his debtor happens to be a national bank.

A

The National Bank Act does not limit the lien of a secured creditor of a national bank upon the appointment of a receiver therefor

With reference to the appointment of receivers for and the winding up of the affairs of national banks, the National Bank Act provides that the receiver, upon appointment, "shall take possession of the books, records, and assets of every description" (sec. 50; U. S. R. S., sec. 5234), paying over to the Comptroller of the Currency the proceeds of the assets of the bank as liquidated, and that the Comptroller—

> * * * shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; * * * (sec. 50; U. S. R. S. sec. 5236).

There is no suggestion to be found in the National Bank Act to the effect that liens are in any wise affected by the appointment of a receiver. If Congress had intended to change the fundamental rule of law that security for the performance of a contract containing a promise to repay principal and a promise to pay interest equally secures both promises, it would have done so expressly. Fundamental rules are not changed my implication. The provision for ratable dividends, above quoted, in no wise limits a secured creditor's rights in and to his collateral. The section containing that provision deals with the distribution of the general assets of an insolvent bank—not with creditors' other rights. As was said by Chief Justice Fuller in *Scott* v. *Armstrong,* 146 U. S. 499:

> * * * The receiver took the assets of the Fidelity Bank as a *mere trustee* for creditors, and not for value and without notice, and, in the absence of statute to the contrary, subject to all claims and defences that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached (p. 507). [Italics ours.]
>
> * * * * *
>
> * * * The requirement as to ratable dividends, is to make them from what *belongs* to the bank, and that which at the time of the insolvency belongs of right to the debtor does not *belong* to the bank (p. 510). [Italics ours.]
>
> * * * * *

> * * * We cannot believe Congress intended * * * to destroy by implication any right vested at the time of the suspension of a national bank (p. 511).

Chief Justice Taft, then Circuit Judge, said, in *Chemical National Bank* v. *Armstrong* (C. C. A. 6th), 59 Fed. 372, affd. sub nom. *Aldrich* v. *Chemical National Bank,* 176 U. S. 618:

> * * * The suspension of the bank, and its seizure by order of the comptroller, have no effect to change the rights of the creditor with reference to his collateral. He enjoys precisely the same advantage over the unsecured creditor, with respect to the collateral, that he did before the suspension (p. 376).

The interpretation of Section 50 of the National Bank Act (U. S. R. S., sec. 5236) contained in *Scott* v. *Armstrong, supra,* was reaffirmed during this term by this Court in *Willing* v. *Binenstock,* No. 36.

One of the prior contract rights of a secured creditor of a national bank which is vested at the time of its suspension is to hold his collateral until both principal and interest have been paid in full, in accordance with his contract. Insolvency of the bank may prevent him realizing more than a part of his principal out of the general estate, but it does not limit his security rights. Other creditors have no interest in his security until the secured debt is entirely satisfied in so far as it is a lien on

the property of the bank. Their interest is only in the surplus, if any.

Section 52 of the National Bank Act (U. S. R. S. sec. 5242) voids certain preferential transfers by national banks. By doing so, it impliedly recognizes the validity of all others. As was said in *Earle* v. *Carson,* 188 U. S. 42, 47:

> * * * Thus, it is provided, Rev. Stat. sec. 5242, that—
>
> "All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another except in payment of its circulating notes, shall be utterly null and void; * * *"
>
> ***This by a negative affirmative establishes the validity of all contracts otherwise lawful made by the Bank concerning its assets before its failure*** * * *. [Italics ours.]

B

Under the decisions of this Court a secured creditor of a national bank, having a valid contract for interest, is entitled to recover interest in full after the suspension of the bank out of the proceeds of his collateral in accordance with the terms of his contract

A secured creditor of a national bank for which a receiver has been appointed, and the general estate of which is sufficient to pay only a percentage of the allowable claims, has two sources to which he may look for the satisfaction of the bank's debt to him. He is entitled to receive dividends out of the estate of the bank on the amount of his claim as of the date of suspension of the bank on the same basis as unsecured creditors, and he may realize upon his security for both principal and interest to the date of payment. His right to dividends was defined by Chief Justice Fuller in *Merrill* v. *National Bank of Jacksonville,* 173 U. S. 131, 135, as follows:

> * * * a secured creditor of an insolvent national bank may prove and receive dividends upon the face of his claim as it stood at the time of the declaration of insolvency, without crediting either his collaterals, or collections made therefrom after such declaration, subject always to the proviso that *dividends* must cease when from them and from collaterals realized, the *claim* has been paid in full. [Italics ours.]

hat definition was reiterated in *Aldrich* v. *Chemi-l National Bank,* 176 U. S. 618. The question volved in both of those cases was whether a se-red creditor of a national bank should be allowed share in dividends out of its general estate in ceivership on the basis of the amount due him as the date of suspension (the Chancery rule), or the amount due at the date of the filing of his aim (the Illinois rule), or of the amount due on e dividend payment date (the Maryland rule), of the amount of the deficiency, if any, remain-g after he had realized upon his collateral (the ankruptcy rule). The Court adopted the Chan-ry rule and thereby placed secured creditors of tional banks in receivership on the same basis r *dividend purposes* as had been established for nsecured creditors in *White* v. *Knox,* 111 U. S. 4. The case of *Merrill* v. *National Bank of Jack-nville, supra,* involved no question of the extent a secured creditor's lien. The value of the credi-r's security in that case was considerably less an the amount of the indebtedness secured there-, and the court carefully limited its decision to e dividend question involved. To that end Chief ustice Fuller said:

> The requirement of equality of distribution among creditors by the national banking act involves no invasion of prior contract rights of any such creditors, and ought not to be construed as having, or being intended to have, such a result.

> Our conclusion is that the *claims of creditors* are to be determined as of the date of the declaration of insolvency, irrespective of the question whether *particular creditors* have security or not (173 U. S., at p. 147). [Italics ours.]

This Court, in *White* v. *Knox,* 111 U. S. 784, held that dividends should be paid to unsecured creditors of a national bank out of the general estate on the basis of the amounts due claimants as of the insolvency date without regard to interest accruing after that date. The case established a rule of convenience in the distribution of the general estate of a national bank in receivership. It had nothing to do with the security rights of a secured creditor, and a reading of the opinion, delivered by Chief Justice Waite, leaves no doubt that the only question considered by the Court was with respect to the distribution of the general estate. For example, he said, in part:

> * * * The only claims the comptroller can recognize in the settlement of the affairs of the bank are those which are shown by proof satisfactory to him or by the adjudication of a competent court to have had their origin in something done before the insolvency. It is clearly his duty, therefore, *in paying dividends,* to take the value of the claim at that time as the basis of distribution. If interest is added on one claim after that date *before the percentage of dividend is calculated,* it should be upon all, otherwise

> the distribution would be according to different rules, and not ratably as the law requires (p. 787). [Italics ours.]

In short, that case decided the basis on which dividends are payable to unsecured creditors out of the general estate of an insolvent national bank, and decided no more.

Certain of the Circuit Courts of Appeals apparently have misunderstood the decision in *White* v. *Knox,* and have failed to grasp the true significance of the proviso contained in that part of the opinion in the *Merrill* case quoted above, *supra* p. 8. Thus, the Circuit Court of Appeals for the Third Circuit, in *Richman* v. *First M. E. Church of Collingswood,* 76 Fed. (2d) 344, which case involved the security rights of a person having a statutory lien such as that of the claimants in this case, said:

> * * * Interest is not allowable, as a general rule, after property of an insolvent is in custodia legis. * * * *This has been specifically ruled as to national banks. White* v. *Knox,* 111 U. S. 784, * * * (p. 346). [Italics ours.]

The opinions in *Douglass* v. *Thurston County* (C. C. A. 9th), 86 Fed. (2d) 899, and *Fash* v. *First National Bank* (C. C. A. 10th), 89 Fed (2d) 110, both of which cases involved the rights of secured depositors, also contain language evidencing an apparent misunderstanding of the decision in *White* v. *Knox* and of the above quoted proviso in the opinion in the *Merrill* case.

Conceivably the decisions in the *Richman, F* and *Douglass* cases, *supra,* can be justified by ing effect to the distinction which may be n between interest allowable as damages for withholding of money due and interest specifi or impliedly contracted for. Be that as it n that distinction is not mentioned in the opinio any of those cases and all three of the opin indicate that the misunderstanding is cle traceable to a failure to distinguish a sec creditor's security rights from his rights to dends, with the result that language whic applicable only to dividend rights has been loo used in discussing security rights.

The statement that interest is not allowable a property of an insolvent is in custodia legis i curate only in so far as it states a result witl spect to creditors' rights to dividends out of general estate of a national bank in receivershi the usual case, that is, where the general esta sufficient to pay only a percentage of the ba debts. It has no application to creditors' secu rights except in the distribution of an insuffi fund among lienors of the same rank. In fa has no application to any creditor's right to dends out of the general estate of a national b in receivership, if the general estate proves t sufficient to pay more than principal. *Nati Bank of the Commonwealth* v. *Mechanics' tional Bank,* 94 U. S. 437; *Richmond* v. *I*

121 U. S. 27.[1] Nor, indeed, has it any application to creditors' rights to dividends out of an estate in equity receivership or even in bankruptcy, in such a case. Cf. *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, where the question involved was whether interest was recoverable for the period of a receivership by a creditor having a statutory lien for supplies sold to the defendant prior to the receivership. Mr. Justice Lamar, who delivered the opinion of the Court in that case, in discussing creditors' dividend rights, said:

> * * * *But that rule did not prevent the running of interest during the Receivership;* and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest

[1] In *National Bank of the Commonwealth* v. *Mechanics' National Bank*, it was held that before the assets of a national bank, of which the Comptroller of the Currency has taken possession for liquidation in accordance with the Act, may be returned to its shareholders, its creditors are entitled to demand and receive interest on their claims down to the date of final payment, including as to creditors who have not contracted for interest, interest at the legal rate, computed from the date of demand and refusal according to the practice in entering judgments.

In *Richmond* v. *Irons*, it was decided that, in determining the extent of the liability of shareholders of a national bank, interest accrued on creditors' claims up to the date of payment should be taken into consideration, subject to the limitation, of course, that the shareholders could not be held liable for more than the par value of their shares.

> as well as principal should be paid. Even in bankruptcy, and in the face of the argument that the debtor's liability on the debt and its incidents terminated at the date of adjudication and as a fixed liability was transferred to the fund, it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to interest accruing after adjudication. 2 Blackstone's Comm. 488; Cf. *Johnson* v. *Norris,* 190 Fed. Rep. 459, 460 (5) (pp. 266–7). [Italics ours.]

The use by certain of the Circuit Courts of Appeals of language, in describing and determining security rights, that merely states a result in certain instances with respect to creditors' rights to dividends, could have had no other result than that which has occurred, namely, to lead to the confusion to which petitioners refer in their petition for the writ of certiorari herein. If the rights of a secured creditor in and to his security and his rights to ratable dividends out of the insolvent estate of a national bank are considered separately, without confusing the one with the other, and without using language with respect to one which is only applicable in certain instances to the other, we submit that the definition of his rights is a comparatively simple matter.

As to his security rights, it is perfectly clear that the insolvency of the bank does not alter, modify, or limit the same. A contention to the contrary was

fully disposed of in *Scott* v. *Armstrong*, 146 U. S. 499, in which Chief Justice Fuller, in rendering the opinion of the Court, in part, said:

> We do not regard this position as tenable. Undoubtedly, any disposition by a national bank, being insolvent or in contemplation of insolvency, of its choses in action, securities or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden; *but liens, equities or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated.* * * * *The requirement as to ratable dividends,* is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank (p. 510.) [Italics ours.]
>
> * * * * * * *
>
> * * * We cannot believe Congress intended * * * to destroy by implication any right vested at the time of the suspension of a national bank (p. 511).

Where, as has previously been pointed out, *supra* p. 3, the lien of a secured creditor, existing prior to insolvency, is not affected by insolvency, it extends to interest accruing until the indebtedness of the insolvent to him is paid in full. On that point, Circuit Judge Sanborn, in delivering the opin-

ion of the Circuit Court of Appeals for the Eighth Circuit in *Coder* v. *Arts* (C. C. A. 8th), 152 Fed. 943, aff'd. 213 U. S. 223, said:

> * * * By the terms of the note and mortgage the mortgagor agreed to pay interest on his debt until it was paid, and that the mortgaged lands might be sold by the mortgagee, and that their proceeds might be applied to the payment of this debt and interest. The covenant for the sale and the application of the proceeds of these lands to the payment of the debt and interest was valid and binding, and it ran with the land, *so that when the latter came to the hands of the trustee it was mortgaged for the payment of the interest as much as for the payment of the principal, and the proceeds of its sale necessarily came to his possession subject to the same charge.* Another rule might prevail if the proceeds of the mortgaged property were insufficient to pay the mortgage debt and its interest in full and the mortgagee was seeking to collect an unpaid balance by sharing with other creditors in the distribution of the common property. He might not be entitled, then, to recover from the proceeds of the common property interest upon his debt to any later date than the unsecured creditors would recover interest upon their claims. But the proceeds of these mortgaged lands appear to be ample to pay the principal and interest of the debt to the mortgagee Arts, and where a trustee sells mortgaged property of the bankrupt's

> estate free of the mortgage, and the proceeds of the sale are sufficient for that purpose, the mortgagee is entitled to payment of the interest upon his mortgage debt as well as the principal, out of the proceeds in accordance with the terms of the note and mortgage (p. 950). [Italics ours.]

The decisions of this Court, defining the rights of unsecured creditors of a national bank to dividends and defining and distinguishing the rights of secured creditors to dividends and their rights in and to their security, may be summed up as follows:

1. Unsecured creditors receive ratable dividends on the amounts due by the bank to them as of the "insolvency" date. *White* v. *Knox*, 111 U. S. 784.

2. Secured creditors receive dividends on the same basis as unsecured creditors. *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131; *Aldrich* v. *Chemical National Bank*, 176 U. S. 618.

3. The appointment of a receiver for a national bank does not stop the running of interest on debts owing by the bank, and *dividends* are payable to all creditors on account of interest after principal has been paid. *National Bank of the Commonwealth* v. *Mechanics National Bank*, 94 U. S. 437; *Richmond* v. *Irons*, 121 U. S. 27.

4. All creditors, secured and unsecured, must first get principal in full before any of them can get anything by way of *dividends out of the general estate* to apply on post

closing interest. *Sexton* v. *Dreyfus,* 219 U. S. 339.[2]

5. The failure to pay one creditor of a national bank his ratable dividend at the same time that other creditors receive their dividends entitles the creditor, who has been delayed through no fault of his own in receiving his dividend, to damages measured by way of interest on the amount of his dividend from the date on which the dividend should have been paid to the date of payment. *Armstrong* v. *American Exchange National Bank,* 133 U. S. 433, 470.

6. The appointment of a receiver for a national bank does not invalidate legal or equitable rights then existing in respect to its assets. *Scott* v. *Armstrong,* 146 U. S. 499.

7. A secured creditor's right to *dividends* ceases "when from them and from collaterals realized, the *claim*" (as contrasted with principal of and interest on the secured in-

[2] *Sexton* v. *Dreyfus* was a bankruptcy, not a bank case. However, Mr. Justice Holmes, in delivering the opinion of the Court, pointed out that the conclusion which the Court reached was somewhat sustained by analogy in the case of insolvent banks and cited both the *Merrill* case and *White* v. *Knox.* The *Sexton* case involved an additional point, namely, whether in determining the amount of a secured creditor's allowable claim income from collateral should be applied to the indebtedness as of the date of the filing of the petition or to interest accruing after that date. This Court held that the income should be applied to post insolvency interest. In *Gamble* v. *Wimberly* (C. C. A. 4th), 44 Fed. (2d) 329, the same principle was applied in the case of a national bank.

debtedness) "has been paid in full" and "their right to retain their securities ceases" when they "have received payment in full" (that is principal of and interest on the secured indebtedness). *Merrill* v. *National Bank of Jacksonville,* 173 U. S. 131, 135, 147. [Italics ours.]

II

A RULE TO THE EFFECT THAT THE APPOINTMENT OF A RECEIVER FOR A NATIONAL BANK LIMITS THE LIENS OF ITS SECURED CONTRACT CREDITORS WOULD BE DETRIMENTAL TO NATIONAL BANKS

In our opinion the adoption of a rule denying creditors who loan money to national banks the right to collect interest out of collateral, as contrasted with the opposite rule, would result in discrimination by banks and other lending institutions against national banks in favor of state banks and would have injurious results to depositors and unsecured creditors of national banks which are placed in receivership and would force national banks to pursue practices which are not only unsound but which would be injurious both to their depositors and creditors and to the public at large.

If the situation were such that lending banks and other financial institutions recognized that secured creditors of national banks could not realize interest after insolvency out of security, loans would probably not be made to national banks except on readily marketable collateral and the present

normal flow of credit would be seriously impeded. This disadvantage would be felt by national banks in the conduct of business during normal times as they would be compelled, from time to time, to sell their investments to meet temporary needs for cash instead of being able to borrow and pledge their assets as is normally done. The disadvantage, however, would have more far reaching consequences during periods of depression when it is not possible for banks to liquidate their assets satisfactorily and with sufficient rapidity to meet heavy deposit demands, and national banks, finding as a result of such a rule that the normal avenues of credit were closed to them, would have no other course but to sacrifice assets at prices which would be certain to bring on insolvency to the detriment of their depositors and creditors and thereby increase the depth of the depression to the detriment of the public at large by tying up purchasing power in the form of frozen bank deposits.

The raison d'être of banks and similar financial institutions is the collection of interest. They are not interested in acquiring title to security which they hold as collateral, and, as a rule, prefer to leave the responsibility for the handling of the liquidation of security to the borrowing bank or its receiver. Admittedly, a borrowing bank, with its intimate knowledge of its own assets, its familiarity with local conditions, and its close contact with the

people with whom it has to deal, or its receiver with that knowledge, familiarity, and contact, can, with proper supervision and guidance, handle the liquidation of a bank's assets so as to obtain the most therefrom, and it is only through a liquidation conducted in an orderly manner over a reasonable period of time that real, as contrasted with sacrifice, values can be obtained. This has been abundantly proved by the experience of the Reconstruction Finance Corporation, which has been that the equity of depositors and unsecured creditors of banks in collateral security can not only be protected and preserved, but, in fact, enhanced during liquidation by the bank's receiver if the liquidation is conducted in accordance with an orderly and properly supervised program.

If perchance a bank or other lending institution should overlook the effect of such a rule and make a loan to a national bank and the bank should go into receivership, there would be no other prudent course for the lending institution to follow, in the interest of self preservation, but to foreclose immediately upon the collateral. By such a course the lending bank would destroy the equity of the depositors and creditors of the borrowing bank in the collateral, which equity would otherwise have been protected, preserved, and possibly enhanced through an orderly liquidation over a reasonable period of time.

CONCLUSION

The true rule, consistent with this Court's interpretation of the National Bank Act, is that where a creditor of a national bank realizes from security an amount sufficient to pay the principal sum owing to him at the date of the appointment of the Receiver, together with interest accruing on the principal balances due from time to time, the creditor is absolutely entitled to retain, out of the proceeds of such collateral sufficient sums to pay both principal and interest, calculated in accordance with his contract to the date of final payment.

If this Court, in deciding the extent of the lien of the claimants herein, as created by Section 11 (k) of the Federal Reserve Act, holds, by reason of the distinction between damages by way of interest and interest pursuant to contract, or for other reasons, that such a lien does not extend to damages, measured by interest in full, then it is respectfully requested that the Court's opinion shall clearly indicate that its decision is limited to the question of the extent of the statutory lien of an owner of funds delivered to a national bank for investment and held by it awaiting investment at the time the bank closes, and that its decision has no application to the right of a secured creditor of such a bank, having a valid contract for interest, to recover interest in full out of the proceeds of

his collateral in accordance with the terms of his contract.

Respectfully submitted.

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APPENDIX

Federal Reserve Act, as Amended

SECTION 11. Enumerated Powers:

The Board of Governors of the Federal Reserve System shall be authorized and empowered:

* * * * *

(k) *Permitting national bank to act as trustees, etc.*—To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this chapter.

National banks exercising any or all of the powers enumerated in this subsection (k) shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper

detail all transactions engaged in under authority of this subsection. The State banking authorities may have access to reports of examination made by the Comptroller of the Currency insofar as such reports relate to the trust department of such bank, but nothing in this chapter shall be construed as authorizing the State banking authorities to examine the books, records, and assets of such bank.

No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Board of Governors of the Federal Reserve System.

In the event of the failure of such bank the owners of the funds held in trust for investment shall have a lien on the bonds or other securities so set apart in addition to their claim against the estate of the bank.

Whenever the laws of a State require corporations acting in a fiduciary capacity, to deposit securities with the State authorities for the protection of private or court trusts, national banks so acting shall be required to make similar deposits, and securities so deposited shall be held for the protection of private or court trusts, as provided by the State law.

National banks in such cases shall not be required to execute the bond usually required of individ-

uals if State corporations under similar circumstances are exempt from this requirement.

National banks shall have power to execute such bond when so required by the laws of the State.

In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator, or in any capacity specified in this section, shall take an oath or make an affidavit, the president, vice president, cashier, or trust officer of such national bank may take the necessary oath or execute the necessary affidavit.

It shall be unlawful for any national banking association to lend any officer, director, or employee any funds held in trust under the powers conferred by this section. Any officer, director, or employee making such loan, or to whom such loan is made, may be fined not more than $5,000, or imprisoned not more than five years, or may be both fined and imprisoned, in the discretion of the court.

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Board of Governors of the Federal Reserve System may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly: *Provided,* That no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies, and corporations exercising such powers.

Any national banking association desiring to surrender its right to exercise the powers granted under this subsection, in order to relieve itself from the necessity of complying with the requirements of this subsection, or to have returned to it any securities which it may have deposited with the State authorities for the protection of private or court trusts, or for any other purpose, may file with the Board of Governors of the Federal Reserve System a certified copy of a resolution of its board of directors signifying such desire. Upon receipt of such a resolution, the Board of Governors of the Federal Reserve System, after satisfying itself that such bank has been relieved in accordance with State law of all duties as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics or other fiduciary, under court, private, or other appointments previously accepted under authority of this subsection, may, in its discretion, issue to such bank a certificate certifying that such bank is no longer authorized to exercise the powers granted by this subsection. Upon the issuance of such a certificate by the Board of Governors of the Federal Reserve System, such bank (1) shall no longer be subject to the provisions of this subsection or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto, (2) shall be entitled to have returned to it any securities which it may have deposited with the State authorities for the protection of private or court trusts, and (3) shall not exercise thereafter any of the powers granted by this subsection without first applying for and obtaining a

new permit to exercise such powers pursuant to the provisions of this subsection. The Board of Governors of the Federal Reserve System is authorized and empowered to promulgate such regulations as it may deem necessary to enforce compliance with the provisions of this subsection and the proper exercise of the powers granted therein.

Regulations of the Board of Governors of the Federal Reserve System. Regulation F, Trust Powers of National Banks

SECTION 9. Trust Funds Awaiting Investment or Distribution:

* * * * *

(b) *Use in conduct of business of trustee bank.*—Funds received or held by a national bank as fiduciary awaiting investment or distribution shall not be used by the bank in the conduct of its business, unless the bank, under authorization by its board of directors, first delivers to the trust department, as collateral security—

(1) Bonds, notes, bills, certificates of indebtedness or other direct obligations of the United States, or obligations fully guaranteed by the United States as to principal and interest; or

(2) Other readily marketable securities of the classes in which State trust companies or State banks exercising trust powers are authorized or permitted to invest trust funds under the laws of the State in which such national bank is located; or

(3) Other readily marketable securities of the classes defined as "investment securities" pursuant to section 5136 of the Revised Statutes of the United States, as amended.

The securities so deposited as collateral shall be owned by the national bank and shall at all times be at least equal in market value to the amount of the trust funds so used in the conduct of the bank's business.

Bankruptcy Act, as Amended

SECTION 67. Liens:

* * * * *

d. Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by this Act.

National Bank Act, as Amended

SECTION 50 (U. S. R. S. sec. 5236):

From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.

SECTION 50 (U. S. R. S. sec. 5234):

On becoming satisfied, as specified in this act, that any association has refused to pay its circulating notes as therein mentioned, and is in default, the Comptroller of the Currency may forthwith appoint a receiver, and require of him such bond and security as he deems proper. Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings.

Provided, That the comptroller may, if he deems proper, deposit any of the money so made in any regular Government depositary, or in any State or national bank either of the city or town in which the insolvent bank was located, or of a city or town as adjacent thereto as practicable; if such deposit is made he shall require the depositary to deposit United States bonds or other satisfactory securities with the Treasurer of the United States for the safe-keeping and prompt payment of the money so deposited: *Provided,* That no security in the form of deposit of United States bonds, or other-

wise, shall be required in the case of such parts of the deposits as are insured under section 12B of the Federal Reserve Act, as amended. Such depository shall pay upon such money interest at such rate as the comptroller may prescribe, not less, however, than 2 per centum per annum upon the average monthly amount of such deposits.

SECTION 52 (U. S. R. S., sec. 5242):

All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court.

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SUPREME COURT OF THE UNITED STATES.

No. 374.—October Term, 1937.

Ticonic National Bank, Peoples-Ticonic National Bank, et al., Petitioners, *vs.* Lottie F. Sprague and Margaret Davis Sprague.	On Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit.

[March 7, 1938.]

Mr. Justice Reed delivered the opinion of the Court.

The question for decision is whether or not a secured creditor of a national bank, holding a non-interest bearing claim, is entitled to interest for any period subsequent to the insolvency of the bank, when the assets on which he has a lien are sufficient to pay the principal and interest but the total assets of the bank are not sufficient to pay in full all creditors' claims as of the date of insolvency.

On March 28, 1931, respondent Lottie F. Sprague delivered $5,022.18 to the trust department of the Ticonic National Bank of Waterville, Maine, in trust, under an agreement which authorized the trustee to invest in bonds or securities and to deposit at least $1,000 in its savings department at usual rates of interest; required specified monthly payments, subject to certain conditions, to Margaret Sprague, also a respondent here; and reserved to the grantor the right to revoke the trust and resume possession of the trust funds.

The Ticonic Bank had been authorized by the Federal Reserve Board to act in a trust capacity, as provided in Section 11(k) of the Federal Reserve Act, as amended (12 U. S. C., § 248(k)). That Act provides that funds held in trust awaiting investment "shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities" approved by the Board of Governors of the Federal Reserve System, and further provides that "In the event of the fail-

ure of such bank the owners of the funds held in trust for in ment shall have a lien on the bonds or other securities so set a in addition to their claim against the estate of the bank."

Pending investment of funds under the Sprague trust, and suant to its resolution implementing the statutory provision quoted, the Ticonic Bank placed the funds of this trust, along other trust funds awaiting investment or distribution, as a dep in its commercial checking department to the credit of its t department, and secured the total amount of such funds by set aside in the trust department bonds, including $20,000 Kingdo Denmark 6's, 1942, at least equal in value to the total amoun such deposits.

On July 29, 1935, respondents, the settlor and benefici brought this suit in the District Court for Maine to have the b held as security with respect to the trust. It appears that on gust 3, 1931, Ticonic Bank sold its assets (including the Denm bonds) to the Peoples National Bank (later called Peoples-Tic National Bank) in consideration of its agreement to "assum pay all the indebtedness of said Ticonic Bank to its depositor that Ticonic Bank then went into voluntary liquidation; that March 4, 1933, the Peoples-Ticonic Bank was closed; that Art Picher was appointed receiver for Peoples-Ticonic Bank on Nov ber 6, 1933, and subsequently, on June 28, 1934, for the Tic Bank, which had been continuing its voluntary liquidation.

The lower courts treated the suit, brought against both banks against Picher as receiver, as one to assert and enforce the protecting the uninvested funds. They held that, in view Section 11 (k) of the Federal Reserve Act, as amended, resp dents had acquired a lien upon the bonds set apart by the conic Bank to secure the deposit of the trust department; that this lien had never been discharged or divested and so exten to the proceeds of the Denmark bonds, which had been sold by receiver for $20,722.66. We do not pause to state the conclusi of fact and of law by means of which the lower courts arrived this result, for in the grant of the writ of certiorari this C declined to review the ruling that a statutory lien for the protect of the owners of the funds held for investment extended to the p ceeds of the Denmark bonds, the lower courts having predica their decision in large part on the facts of this particular case.

The decrees below did not end with the matters just stated. The District Court, finding that the proceeds of the bonds exceeded the trust funds on deposit,[1] held the respondents entitled to payment in full of $3,649.65, the amount to which the Sprague trust account had been reduced, with interest from the date of the filing of the bill of complaint. At first the Circuit Court of Appeals reversed that part of the decree allowing interest, but on rehearing it affirmed the decree in toto, approving the allowance of interest out of the proceeds of the Denmark bonds, which it assumed were sufficient to meet with interest the amount of all trust deposits. It ruled that although the requirement of ratable distribution precludes the recovery of interest against the general funds of an insolvent national bank, the general creditors have no rights in the trust funds here involved until after the secured claims are paid.

The attention of this Court was called to the fact that the ruling conflicted with decisions in other circuits, where secured creditors were held not entitled to any interest after the suspension of the national bank,[2] and for this reason certiorari was granted, limited to this question of interest. — U. S. —.

As an incident to the right to recover an unexpended balance in a deposit, a depositor is entitled to interest as damages for the failure to pay that balance upon demand.[3] Compare *Stewart* v. *Barnes*, 153 U. S. 456, 462; *United States* v. *North Carolina*, 136 U. S. 211, 216.

The bank's obligation to pay interest as damages for the detention of the debt is not cut off by suspension of its business and receivership. The principle has been established, and claimants held entitled to such interest, in cases where the principal amount of each of the claims was paid in full from the assets of the bank (*National*

[1] The total uninvested trust funds on deposit in the commercial department of the Ticonic Bank amounted to about $10,000 at the time of the sale of its assets, and to about $12,000 when the Peoples-Ticonic Bank was closed in 1933.

[2] Richman *v.* First Methodist Episcopal Church of Collingswood, 76 F. (2d) 344, 346 (C. C. A. 3d), certiorari denied, Long *v.* First Methodist Episcopal Church, 296 U. S. 593; Douglas *v.* Thurston County, 86 F. (2d) 899, 909 (C. C. A. 9th); Fash *v.* First Nat'l Bank of Alva, 89 F. (2d) 110, 112 (C. C. A. 10th).

[3] We need not explore petitioner's suggestion, that if interest is granted at all it should be measured from an earlier date than that of the judicial demand contained in the bill of complaint, since respondent has filed no cross-petition for certiorari complaining of that restriction (Langnes *v.* Green, 282 U. S. 531, 536-538).

Bank of the Commonwealth v. *Mechanics' National Bank,* 94 U. S. 437), including if necessary the double liability of the shareholders (*Richmond* v. *Irons,* 121 U. S. 27, 64).

It is true that in the liquidation of national banks, dividends from the general funds on unsecured claims are made pro rata upon the amount of each claim as of the date of the insolvency, *White* v. *Knox,* 111 U. S. 784. This method of distribution gives a proportional part of the available funds to each creditor, in accordance with the statute requiring a "ratable dividend." R. S. § 5236. Whether the reason for this method of determining dividends is to avoid prejudice from the inevitable delay of court proceedings for liquidation (*In re Humber Ironworks and Shipbuilding Company,* IV Ch. App. Cas. 643, 646; *American Iron and Steel Manufacturing Co.* v. *Seaboard Air Line Ry.,* 233 U. S. 261, 266; cf. *People* v. *American Loan & Trust Company,* 172 N. Y. 371, 379); to facilitate administration (*Sexton* v. *Dreyfus,* 219 U. S. 339, 344; *Chemical National Bank* v. *Armstrong,* 59 Fed. 372, 387); or because on that date the creditors acquire a right in rem against the assets in the hands of the receiver (*Chemical National Bank* v. *Armstrong, supra,* 379; *Merrill* v. *National Bank of Jacksonville,* 173 U. S. 131, 140; *Sexton* v. *Dreyfus, supra,* 345) is immaterial. Dividends are paid on that basis. It is in order to assure equality among creditors as of the date of insolvency that interest accruing thereafter is not considered. But interest is proper where the ideal of equality is served, and so a creditor whose claim has been erroneously disallowed is entitled on its allowance to interest on his dividends from the time a ratable amount was paid other creditors. *Armstrong* v. *American Exchange National Bank,* 133 U. S. 433, 470.

The rule of *White* v. *Knox, supra,* does not require that interest be denied to the secured creditors unless the principle of equality of distribution is to be applied as between all creditors. Secured creditors have two sources of payment for their claims—the liability of the debtor and the liability of the pledged or mortgaged assets. One is personal, the other in rem. The liability in personam of the bank gives rise to a claim in rem against the free assets in the hands of the receiver; the claim in rem against the security continues as a claim in rem against that same security. With respect to the former the secured creditors have merely the same rights as any general creditor, and in so far as dividends are paid to

ecured creditors from free assets, they share ratably with the unecured creditors, and their claims bear interest to the same date, iat of insolvency. Compare *Merrill* v. *National Bank of Jacksonille*, 173 U. S. at 146; *Aldrich* v. *Chemical National Bank*, 176 . S. 618, 638. But to the extent that one debt is secured and nother is not there is manifestly an inequality of rights between he secured and unsecured creditors, which cannot be affected by he principle of equality of distribution (*American Iron and Steel Manufacturing Co.* v. *Seaboard Air Line Ry., supra*, at 266; *Chemcal National Bank* v. *Armstrong, supra*, at 376-377), and interest ecruing after insolvency may not be withheld on account of that rinciple.

The rule as to the date to which interest is to be allowed on ecured claims sharing pro rata with unsecured claims, cannot apply to the disposition of pledged or mortgaged assets subject to he lien of individual creditors, unless we are to disregard the rights n these assets acquired prior to insolvency. But "liens, equities or rights arising . . . prior to insolvency and not in contemplation thereof are not invalidated." *Scott* v. *Armstrong*, 146 U. S. 499, 510; *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, 145. By contract or, as in this case, by statute, the secured creditors gain or are given a lien on or right in property 'in addition to their claim against the estate of the bank." Section 11(k) of the Federal Reserve Act as amended. The statutory ien prior to receivership withdrew the pledged security from the ssets of the bank available to general creditors, in so far as night be necessary to satisfy the lien. Though title to the collateral was in the name of the bank, it was subject to this lien, and o that extent the property pledged could not properly be said to elong to the bank for purposes of distribution to creditors. *Scott* . *Armstrong, supra* at 510.

As the obligation to pay interest is not destroyed by the insolency and as the rights of the secured creditor in his collateral, contractual or statutory, are likewise unaffected, we are of the opinion hat a secured creditor of a national bank in receivership may enorce his lien against his security, where it is sufficient to cover both rincipal and interest, until his claim for both is satisfied.

With respect to analogous liquidations the rule just announced

has long been in force.[4] This Court has already held that a lien-holder may look to his lien not only for the principal but also for interest accruing up to the date of payment, though his debtor has gone into bankruptcy (*Coder* v. *Arts*, 213 U. S. 223, 245, affirming, 152 Fed. 943, 950) or into equity receivership (*American Iron and Steel Mfg. Co.* v. *Seaboard Air Line Ry. Co.*, 233 U. S. 261), and though interest will be denied the unsecured creditors if the assets are insufficient to pay all claims in full. Compare *In re Humber Ironworks and Shipbuilding Co.*, IV Ch. App. Cas. 643, with *In re Humber Ironworks and Shipbuilding Co.*, V Ch. App. Cas. 88. The same rule was applied to state banks in *Washington-Alaska Bank* v. *Dexter Horton National Bank*, 263 Fed. 304, 306.

Petitioners suggest that the rule just laid down may have the effect of penalizing the unsecured creditors for the precaution of the receiver in litigating doubtful claims asserted against segregated assets. This could be true only where the interest accruing to the secured creditors during the pendency of the litigation exceeds the appreciation in value of, and the income from, the security. And since in many cases if the receiver is successful his conduct of the litigation will inure to the advantage of the general creditors, they may fairly be charged with the expenses of contesting the claim, including interest by way of damages. Cf. *Chemical National Bank* v. *Armstrong*, *supra*, 59 Fed. at 384.

Affirmed.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[4] Compare 7 Vin. Abr. 110: "*A mortgagee shall have his interest run on* upon a bankrupt's estate, because he hath a right in rem, *but as to other interest, it ceaseth on the bankruptcy.* Per Ld. Chan. King, 18 July 1729."